

DRAFT REPORT

MARKET ANALYSIS FOR WORKSPACE DEVELOPMENT IN COYOTE VALLEY

Prepared for:

City of San Jose

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I. INTRODUCTION AND SUMMARY OF FINDINGS

Economic & Planning Systems, Inc. (EPS) has been retained by the City of San Jose to provide a variety of economic consulting services in furtherance of the creation of the Coyote Valley Specific Plan. A key part of these services is the assessment of market conditions for residential, retail, and workspace development. This report presents EPS's findings regarding the current and future market prospects for the development of office, R&D, and industrial workspace at Coyote Valley.

BACKGROUND

Coyote Valley is an area comprised of over 7,000 acres of land in the southern part of San Jose and in unincorporated Santa Clara County but within San Jose's sphere of influence. Since the 1980s, San Jose's City Council has maintained a policy that reserves Coyote Valley for future urban development, and establishes goals for the overall development program for the area as well as "triggers" that must be met for the development to begin. Specifically, the policy has maintained that the overall plan for Coyote Valley must reserve over half of the overall acreage as a "greenbelt" on which no urban development can occur, and that the remainder of the land must be developed at sufficient density to accommodate 50,000 "qualifying" jobs (excluding retail and public or quasi-public jobs) and 25,000 housing units. In addition, a trigger has been established that none of the housing development can occur until at least 5,000 of the qualifying jobs are in place in Coyote Valley.

The Coyote Valley Specific Plan is being developed through the joint efforts of the City of San Jose and a multi-disciplinary group of consultants, including EPS. This workspace market assessment is intended to provide information that will help this group of stakeholders to create the following:

1. A land use program that is supported by current and expected market conditions and meets the established goals for the development of Coyote Valley.
2. A financing program that distributes the benefits, costs, and risks of development among the various landowners.
3. An implementation strategy that efficiently phases and locates land use and infrastructure development to optimize the value of development to the landowners, developers, and the City of San Jose.

KEY FINDINGS

The following points summarize the most important findings of this report:

1. **The Coyote Valley Specific Plan should provide for a variety of workspace building typologies, ranging from low-rise industrial and R&D buildings to mid- and high-rise office buildings.** While workspaces generally may be growing more dense, much of the future job growth in Silicon Valley and San Jose will require workspace that is not more than a few stories tall.
2. **Software, computers, Internet services, and biosciences represent the strongest potential industries for tenanting workspace at Coyote Valley.** These industries are expected to grow rapidly, and will be attracted to Coyote Valley's envisioned amenities such as a mixed-use environment, natural features, and proximate housing.
3. **The development of sufficient workspace to accommodate 50,000 qualifying jobs at Coyote Valley is likely to occur over the next three to four decades, not by the year 2020.** Coyote Valley would need to capture an unrealistic 50 percent of all projected net new jobs in the City through 2020 to achieve the goal of 50,000 jobs in that time frame.
4. **The first 5,000 qualifying jobs at Coyote Valley are not likely to be achieved in the next few years, but should be achievable by the year 2012.** This finding has clear implications for the overall development of Coyote Valley, as the current policy directive would preclude housing development until the first 5,000 jobs are in place.

In addition to the findings above, those below provide the conclusions of each chapter of this report.

CHAPTER II: OVERVIEW OF ECONOMIC DYNAMICS

This overview of the Silicon Valley's economic dynamics suggests certain implications for the development of Coyote Valley.

1. **Coyote Valley will benefit substantially from its position in a strong regional economy.** The Silicon Valley is a worldwide leader in many growing technologies and industries, and is expected to continue to draw employers, employees, and investors that will spur real estate development.

2. **Despite recent job losses, the longer-term prospects for job growth in the Silicon Valley are very positive.** The Silicon Valley's workforce quality, economic and institutional infrastructure, quality of life, and brand name recognition will continue to attract investment and employment growth.
3. **The industries most likely to grow in the Silicon Valley region include software, computers, electronics, Internet services, and bioscience.** These industries can capitalize on the high-quality workforce available in the Silicon Valley, and Coyote Valley has an opportunity to capture some of the growth in these industries.
4. **Silicon Valley's employment base is moving away from industrial and traditional R&D space toward higher-density buildings, including multi-story office space.** The office supply is growing more rapidly than the supply of other workspace types, and companies seeking to maximize the value of their Silicon Valley operations are maintaining headquarters and "value-added" services here while locating their more land- and labor-intensive operations elsewhere.
5. **Real estate trends and company performances both suggest limitations on near-term opportunities for large campus-style workspace development for individual tenants.** Far fewer companies in the Silicon Valley are growing quickly than was the case several years ago. Also, real estate developers are increasingly aiming to limit their market exposure by developing incrementally rather than in large simultaneous projects. However, several established firms (Cisco, Xilinx, and IBM) that have property in Coyote Valley do present campus development opportunities.
6. **The provision of an attractive, mixed-use urban working environment should be prioritized at Coyote Valley.** These characteristics will give Coyote Valley a competitive edge over other potential employment locations, as employers and employees are seeking urban services and amenities, transit access, and proximity to housing. Such a plan will also help to address some serious regional issues regarding transportation, air quality, and housing supply.

CHAPTER III: WORKSPACE MARKET CONDITIONS

The downturn in the regional, national, and international economy has had a profound effect on the performance of workspace real estate in the Silicon Valley. Vacancy rates have risen, lease rates have fallen, absorption of workspace has been negative, and new construction activity has slowed to nearly none. The performances of different product types in different locations, however, are informative as to what might be expected or preferred at Coyote Valley. Some of the implications of this market conditions review are as follows:

1. **Office workspace development opportunities appear to be strongest.** Office development has outperformed R&D and industrial development in terms of vacancy rates, lease rates, absorption, and/or new construction during the past five years. These findings hold true for the Silicon Valley generally and for San Jose in particular.
2. **Urban-style office workspace should command premium values.** The performance of Downtown San Jose office space, relative to less urban environments, indicates that vacancy rates and lease rates are comparatively strong for office space in vital, mixed-use urban areas.
3. **For the next several years, R&D space is much more likely to be build-to-suit development than speculative development.** There currently is an estimated supply of nearly 40 million square feet of existing R&D space throughout the Silicon Valley being offered at very low lease rates.
4. **Industrial space appears to represent a less strong development opportunity.** While vacancy rates are relatively low, absorption and construction activity clearly indicate that the Silicon Valley and San Jose economies are shifting away from demand for manufacturing and warehouse space. However, growth in the bioscience industry in particular may provide continued demand for industrial space.
5. **Coyote Valley does not have a monopoly on available land in the City or region.** An adequate supply of land exists in San Jose to accommodate projected job growth and workspace development through 2020. While Coyote Valley clearly has the largest contiguous supply of such land, other properties in existing employment areas will compete for workspace development.

CHAPTER IV: COYOTE VALLEY'S COMPETITIVE POSITION

Coyote Valley has numerous qualities that will make it an attractive location for employers, but there are other potential employment locations that are competitive with or superior to Coyote Valley in certain respects.

1. **Coyote Valley faces significant competition for new development over the next several decades.** Several employment areas in San Jose offer advantages that Coyote Valley most likely never will, such as proximity to highways and the airport, or a critical mass of regionally prominent cultural and entertainment venues. These competitive areas also have vacant land available for future development, and are planned for intensification of existing properties as well.

2. **The availability and affordability of workspace in the competing areas will slow the construction of new workspace in Coyote Valley and elsewhere.** Significant amounts of office and R&D space are available in competitive locations, and for most companies these can be occupied more quickly and affordably than the development of new space at Coyote Valley.
3. **The corporations that currently own land in Coyote Valley are not planning to develop significant workspace in the near future.** Cisco, Xilinx, and IBM all own land in Coyote Valley, but only Xilinx has plans to commence even a small amount of workspace construction in the next several years.
4. **The other competing areas are beginning to incorporate the design features envisioned for Coyote Valley.** While most of the competing areas are developed with low-rise office, R&D, and industrial space, there is evidence of more intensive use of land, including taller buildings, structured parking, and mixed use. Also, transit-oriented development is envisioned and becoming a reality along the light rail line north of Downtown San Jose.
5. **To achieve the desired density of development, Coyote Valley will need to develop advantages that alternative areas may not provide.** Accessible and affordable housing, a vibrant mixed-use environment, attractive natural features and urban design, and convenient transit service will vastly improve Coyote Valley's competitive position.

CHAPTER V: COYOTE VALLEY ABSORPTION PROJECTIONS

Based on projections of overall demand for workspace in the competitive market area of San Jose and the attributes and liabilities of Coyote Valley versus alternative development locations, EPS has estimated the absorption of office, R&D, and industrial space through 2020.

1. **Coyote Valley can potentially capture roughly 1.5 million total square feet of workspace through 2010, and an additional 4.2 million square feet through 2020.** Office space (particularly mid- to high-rise space) represents the largest overall potential market niche for Coyote Valley. R&D/heavy office space represents a smaller niche, due to the large supply of existing and available R&D space.
2. **Demand for mid- to high-rise office space is the most likely to improve during the buildout of the Coyote Valley community.** These uses tend to benefit most from and be most compatible with the type of urban environment envisioned for Coyote Valley. Industrial/warehouse space will be least improved by those features, but very little of that space is envisioned.

3. **In the absence of an unexpectedly large campus office or R&D user, roughly 4,300 jobs can be gained at Coyote Valley by 2010, and an additional 14,500 total jobs by 2020, for an overall total of 18,800 jobs.** Clearly, this number does not reach the goal of 50,000 total jobs at Coyote Valley, so workspace development would be assumed to continue beyond 2020.
4. **The preliminary threshold of 5,000 jobs should be achievable by not later than 2012.** Under the current policy, achieving this 5,000-job threshold would allow for the development of residential and retail uses in Coyote Valley. This threshold may be reached sooner if a major campus user is attracted, but this is not expected.
5. **Workspace development in Coyote Valley is likely to require several decades to reach full build-out.** Coyote Valley would need to capture over 50 percent of projected demand for new office, R&D, and industrial/warehouse workspace in the entire City of San Jose to accommodate 50,000 workers by 2020.

CHAPTER VI: LAND USE PROGRAMMING RECOMMENDATIONS

Based on the findings of this market analysis, EPS makes the following recommendations for the workspace in the Coyote Valley Specific Plan:

1. **The Specific Plan should not be overly aggressive in its assumptions of workspace density.** While mid- to high-rise office development is likely to be increasingly marketable over time, the vast majority of both jobs and workspace now and in the future are likely to be located in low-rise buildings of not more than four stories.
2. **The Specific Plan should assume most of its high-density workspace within the urban core, allowing for low-rise development in the peripheral areas.** Most of the mid- to high-density office space should be primarily located in the urban core, while low-rise office and R&D space should be distributed throughout the plan, including along the transit line and adjacent to the hillsides. Industrial space should be planned with easy access to Highway 101.
3. **The Specific Plan should ensure the development of a mixed-use core with transit access, retail and services, and open space features.** This type of environment should command premium workspace rents, and is also necessary to attract any significant amount of high-density office development.
4. **The Specific Plan should not rely too heavily on the development of the urban core as a near-term “place-making” effort.** The uses in the urban core, including the workspace, the retail, and the housing, are all likely to be more marketable as the remainder of Coyote Valley is built out, rather than before.

CONTENT OF REPORT

Chapter I, this chapter, summarizes the findings of the workspace market assessment. **Chapter II** describes the economic dynamics of the Silicon Valley and the City of San Jose, including the changing economic structure and real estate trends as well as Silicon Valley's competitive position in an increasingly global economy. **Chapter III** discusses workspace market conditions in the Silicon Valley and the City of San Jose, including current and past vacancy and lease rates, absorption trends, and construction activity. **Chapter IV** assesses Coyote Valley's competitive position within the regional context, including a definition of its primary competitive market area and a comparison of Coyote Valley to other potential employment development locations. **Chapter V** presents projections for Coyote Valley's capture of the competitive market demand for office, R&D, and industrial space through 2020, as well as the number of jobs likely to be accommodated in that workspace development. **Chapter VI** discusses the implications of this market assessment on the Coyote Valley Specific Plan, including considerations of workspace product mix, locations, desired amenities, and phasing.